Asset Management One Co., Ltd.

Global Outlook 2026

December 2025

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Asset Management One

Registration No.: Director of Kanto Local Finance Bureau (Financial Instruments Firms) No.324
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Member of Japan Investment Advisers Association
Member of The Investment Trusts Association, Japan

25-051 GBDD

Forecast Summary

Economic Forecast Summary for 2026

Calendar Year		2024 (Actual)	2025 (AMO Estimate)	2026 (AMO Forecast)
US	Real GDP (YoY%)	*2.8*	*1.7*	*1.8*
	Core CPI (YoY%)	*3.4*	*3.0*	*2.6*
Eurozone	Real GDP (YoY%)	*0.9*	*1.4*	*1.2*
	HICP (YoY%)	*2.4*	*2.1*	*1.7*
China	Real GDP (YoY%)	*5.0*	*4.9*	*3.8*
	CPI (YoY%)	*0.2*	*-0.2*	*0.5*
Japan	Real GDP (YoY%)	*-0.2*	*1.2*	*0.7*
	Core CPI (YoY%)	*2.6*	*3.0*	*1.8*

Stock Market Forecast Summary for 2026

Calendar Year		2024 (Actual)	2025 (AMO Estimate)	2026 (AMO Forecast)
US	S&P500	*5882*	*6900*	*7300*
	YoY%	*23.3*	*17.3*	*5.8*
Eurozone	DAX	*19909*	*24500*	*26000*
	YoY%	*18.8*	*23.1*	*6.1*
China	Shanghai Composite	*3352*	*3850*	*3930*
	YoY%	*12.7*	*14.9*	*2.1*
Japan	TOPIX	*2785*	*3350*	*3550*
	YoY%	*17.7*	*20.3*	*6.0*

Bond Market Forecast Summary for 2026

Calendar Year	2024 (Actual)	2025 (AMO Estimate)	2026 (AMO Forecast)
UST 10-Year Yield (%)	*4.57*	*4.00*	*4.00*
Germany 10-Year Yield (%)	*2.37*	*2.70*	*2.90*
Japanese Government Bond (JGB) 10-Year Yield (%)	*1.10*	*1.90*	*1.90*

Source: Bloomberg, Factset, Asset Management One Co., Ltd.
Note: 1. The data doesn't suggest or guarantee any future economic situations, market outlook, other trends related to investment environments, etc. Past performance is not a reliable indicator of future results.
2. For Japan core CPI, all items excluding fresh food
US core CPI, all items excluding food and energy

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United States

Naoki Murakami
Senior Economist

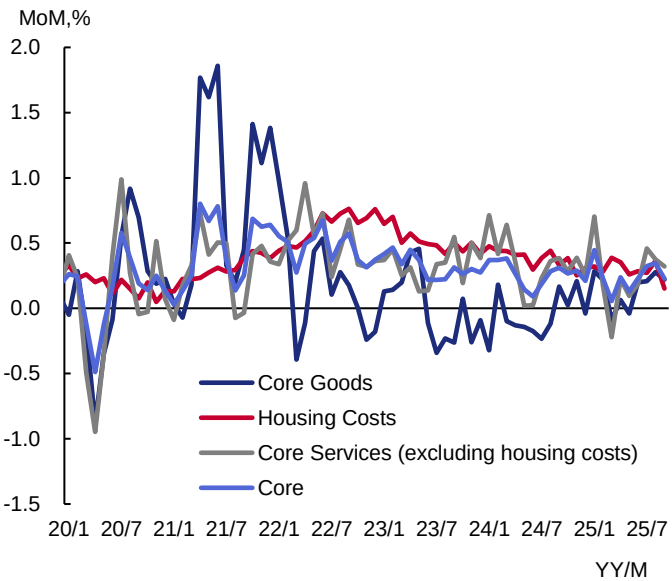
Economic Outlook

The United States economy slowed to an annualised pace of 1.6% in the first half of 2025. During this period, policy rates remained elevated, exerting a tightening effect that weighed on activity, particularly through housing investment. In addition, tariff increases under the Trump administration led households to adopt a more cautious stance, leading to a modest deceleration in consumer spending.
Even so, tariffs did not reach the extreme levels anticipated around “Liberation Day” in April, and retaliatory measures from trading partners were limited. As a result, a sharp downturn in the U.S. economy was avoided. Looking ahead the large-scale tax cuts and spending package (the OBBB Act), enacted in July, is expected to support solid growth. This will be further aided by easing financial conditions as the Federal Reserve moves to cut rates.

The labour market has softened, with job creation slowing, though the rise in unemployment has been modest. Indicators, such as job openings, point to further cooling, yet with the Fed guiding rates back towards neutral, the risk significant disruption in the labour market appears limited. Notably, the recent adoption of AI by firms may be curbing recruitment for entry-level roles, particularly among younger workers. While the effect remains contained for now, greater as AI adoption increases labour demand could be further restrained over time.

Core CPI has remained around 3% year-on-year throughout 2025. On a monthly basis, tariff-related pressures have emerged in certain goods categories, such as apparel and furniture, yet have not triggered a renewed surge in inflation (Figure 1). One explanation may be that firms are absorbing tariff costs, or passing them on to consumers only gradually, which could prolong their impact on prices. That said, housing costs have been easing steadily, and core services excluding housing are expected to slow further as labour market conditions soften. Consequently, core CPI is projected to fall into the low 2% range year-on-year in the second half of 2026.

Figure 1: Trends in Core CPI by Category



Source: LSEG Data & Analytics, Asset Management One Co., Ltd.
Note: Monthly Data from January 2020 to September 2025

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Monetary and Fiscal Policy Outlook

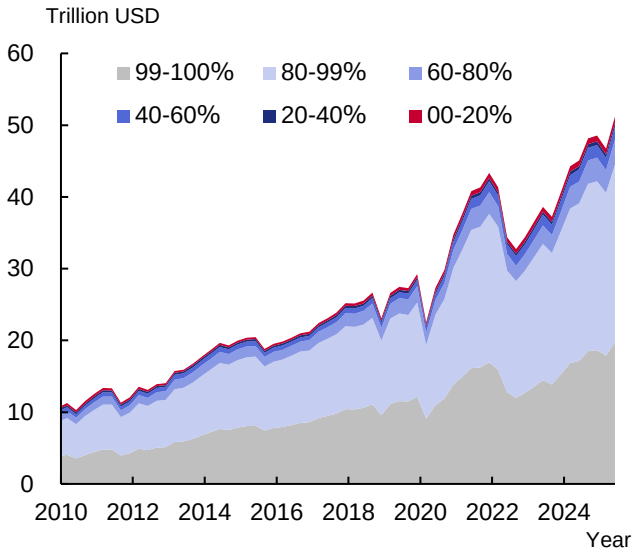
Fed Chair Powell's term ends in May 2026. While some market participants speculate that his successor under the Trump administration might pursue aggressive rate cuts, we view this scenario as unlikely. Any policy perceived as politically driven would undermine confidence in the Fed's independence and could trigger a sell-off in U.S. assets, an outcome the administration would seek to avoid. Therefore, regardless of who assumes the chair, monetary policy decisions are expected to remain guided by the Fed's dual mandate.

We expect the U.S. economy to remain resilient through 2026. With labour market conditions softening, the Fed is likely to follow its December rate cut with another in March 2026, and then maintain rates.

Risk Scenarios

Although U.S. consumer spending appears robust overall, it is increasingly polarised between affluent households and those under financial strain, a "K-shaped" economy. Analysis by the Boston Fed shows that real spending among low-income households has grown only modestly in recent years, while high-income households have seen strong gains, driven by wealth effects from rising equity prices. Since lower-income households hold far fewer stocks and mutual funds (Figure 2), a sharp correction in asset prices, such as in AI-related equities, could dampen consumption among high-income households, posing a downside risk to the U.S. economy.

Figure 2 : Trends in Stock and Investment Trust Holdings by Income Group



Source: The Federal Reserve (FRB), Asset Management One Co., Ltd.
Note: Quarterly data from Q1 2010 to Q2 2025

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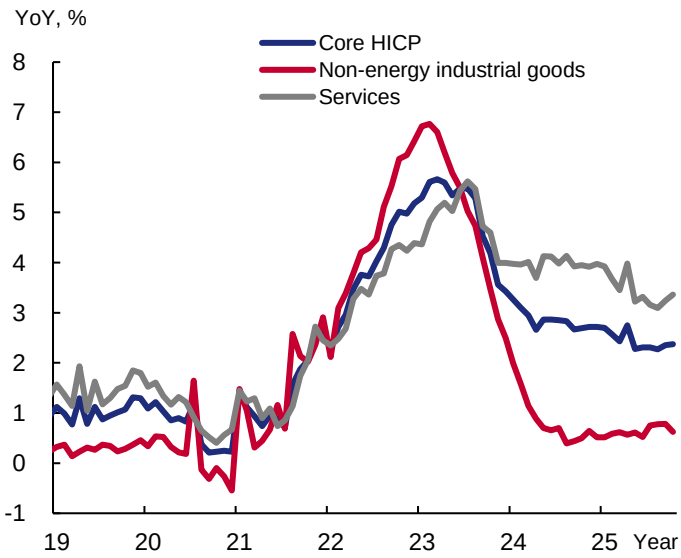
Edamura Yoshihito
Economist

Economic Outlook

The euro area economy is expected to maintain resilient growth in 2026. While tariff measures under the Trump administration may exert some drag, the avoidance of significant tariff hikes, including sector-specific tariffs, should support activity. Fiscal expansion driven by defence and infrastructure investment, particularly in Germany, will also contribute. Growth for 2025 is projected to remain firm with an annualised rate of 1.4%.
Recently, private consumption has been subdued. However, with unemployment continuing to hover near record lows, real wage gains are expected to support a gradual increase in household spending through 2026.

On prices, core HICP, the measure closely monitored by the ECB, has remained in the low 2% range, with service price deceleration has been modest and non-energy industrial goods prices broadly stable (Figure 1).

Figure 1: Core HICP and Components Trends



Source: LSEG Data & Analytics, Asset Management One Co., Ltd.
Note: Monthly data from January 2019 to October 2025

That said, wage indicators, including negotiated wages, point to slowing wage growth. This should lead to a gradual easing in service inflation, allowing disinflation to progress and core inflation to fall below the ECB's 2% target throughout 2026.

Monetary and Fiscal Policy Outlook

At its October meeting, the ECB decided to keep policy rates unchanged. President Lagarde noted that downside risks to growth had receded, citing developments such as a ceasefire in the Middle East and progress in U.S.–China trade negotiations. While she did not rule out further rate cuts entirely, the ECB appears to believe that significant tariff-related downside risks have been avoided. With fiscal stimulus effects expected to materialise, particularly in Germany, the June rate cut is likely to have been the last, with the current 2.0% as the terminal rate. We expect the ECB to maintain policy rates throughout 2026.

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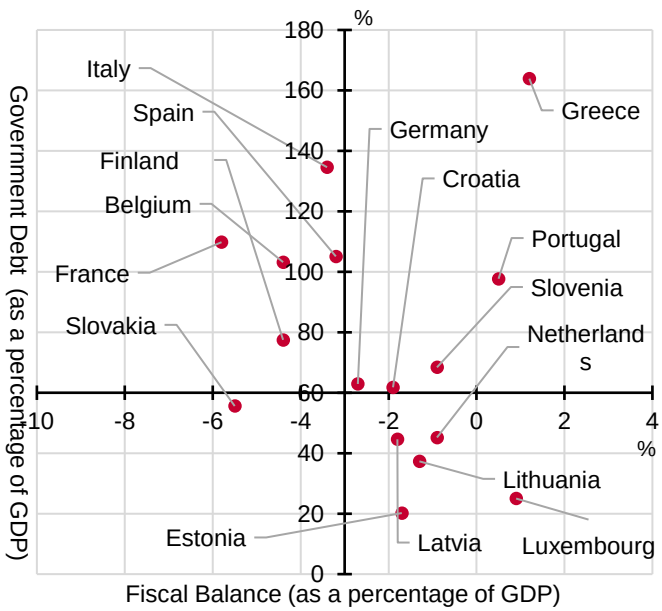
Risk Scenarios

One key risk for 2026 is a slowdown in exports, driven by U.S. tariff increases, euro appreciation, and intensifying competition with China. Thus far, exports to the U.S. surged in March ahead of tariff implementation, then fell sharply during the summer, though they have recently shown signs of recovery. While there is no clear evidence of sustained weakness at present, developments warrant close monitoring.

Additional risks include delays in German fiscal stimulus and limited expansion of defence spending within the EU. The latter is particularly noteworthy: although NATO raised its defence spending target in June 2025, many EU member states have limited fiscal capacity to expand defence budgets (Figure 2), suggesting that any increase may remain modest.

Figure 2: Fiscal Conditions of Selected EU and NATO Member States



Source: Eurostat, Asset Management One Co., Ltd.
Note: 1. Fiscal balance (as a percentage of GDP) refers to 2024, and government debt (as a percentage of GDP) refers to 2025
2. The intersection of the vertical and horizontal axes represents a fiscal deficit of 3% of GDP and government debt of 60% of GDP (EU fiscal rule)

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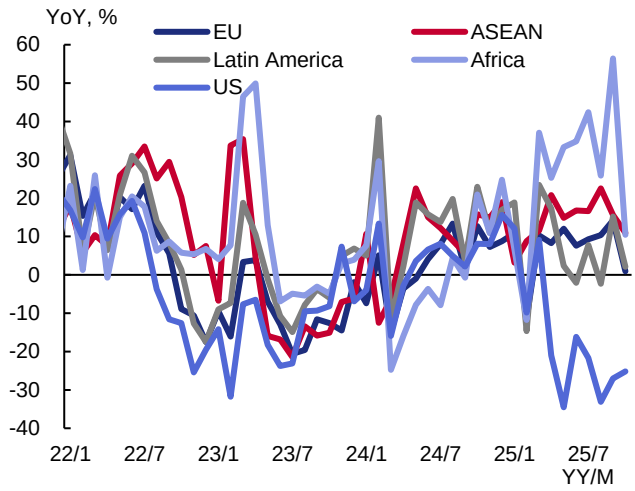
Yuko Iizuka
Economist

Economic Outlook

China's economy in 2025 is expected to achieve the government's annual GDP growth target of around +5%, supported by strong performance in the first half although some deceleration in the second half.

External demand remained resilient as exports to markets outside the United States offset the impact of additional U.S. tariffs (Figure 1).

Figure 1: Export Trends by Country/Region



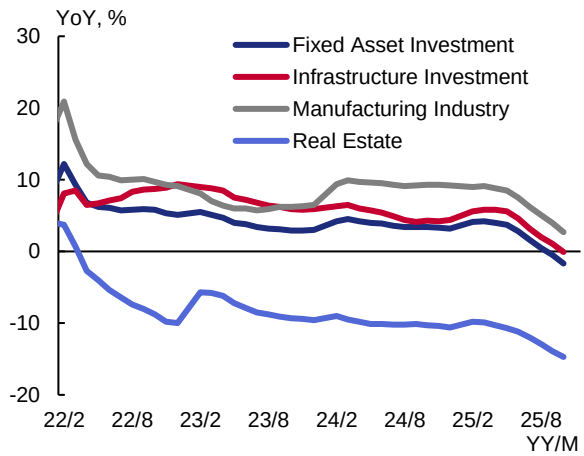
Sources: China Economic Information Center (CEIC), Asset Management One Co., Ltd.
Note: Monthly Data from January 2022 to October 2025

Domestic demand was buoyed in the first half by government incentives replacement for consumer goods, but momentum weakened later in the year as policy effects faded. Structural factors including the continued downturn in the property market, negative wealth effects from real estate, and slow improvement in employment conditions, particularly among younger workers also constrained consumption recovery.

Corporate investment activity contracted amid uncertainty surrounding U.S.–China trade tensions and government efforts to curb overcapacity, further weighing on domestic demand.

The 15th Five-Year Plan (2026–2030) emphasises strengthening self-reliance in high-tech sectors such as AI and semiconductors, reflecting heightened awareness of economic security amid ongoing U.S.–China tensions. This focus is expected to drive a recovery in fixed asset investment, which has recently been in negative territory (Figure 2).

Figure 2: Trends in Fixed Asset Investment



Sources: LSEG Data & Analytics, Asset Management One Co., Ltd.
Note: Year-to-date cumulative; figures for January each year are not disclosed

However, concerns remain that overcapacity and deflationary pressures already evident in traditional sectors could emerge in these new industries as well.

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The plan also outlines measures to expand domestic demand, including boosting consumption, promoting employment, increasing incomes, and improving social security systems, though specific details have yet to be disclosed. While no explicit GDP growth targets were provided, the government reiterated its goal of raising per capita GDP to the level of a moderately developed country by 2035, requiring an average annual growth rate of +4.17%. This suggests that growth targets may be lowered from the current +5% range, implying that the government could tolerate slower growth and refrain from aggressive stimulus beyond 2026.

Monetary and Fiscal Policy Outlook

Fiscal policy is expected to focus on strengthening supply chains in emerging industries and supporting consumption, as outlined in the Five-Year Plan. While details remain unclear, policy support is likely to shift from durable goods to consumption of services. Specific measures and numerical targets are anticipated at the National People's Congress in March 2026, when the full details of the plan will be announced.

On monetary policy, the People's Bank of China has signalled its intention to maintain an "appropriately accommodative" stance, with further rate cuts possible to support domestic demand. However, the government appears to favour targeted measures over broad-based easing, suggesting caution in implementing large-scale rate reductions.

Given the economy's resilience despite signs of slowing, policymakers retain room for manoeuvre and are expected to calibrate fiscal and monetary actions based on evolving domestic and external conditions.

Risk Scenarios

Key risks include persistent U.S.–China tensions. Although the late-October summit resulted in an agreement to reduce tariffs, additional tariffs and other restrictions were only postponed for about a year, leaving negotiations ongoing and maintaining a high potential for renewed friction.

Other risks include prolonged weakness in the property sector and deflationary pressures from overcapacity, which could further delay domestic demand recovery. While housing prices showed tentative signs of stabilisation following mortgage rate cuts and easing of purchase restrictions, recent data indicate renewed declines on a month-on-month basis. Moreover, the government's continued emphasis on strengthening supply chains may perpetuate downward pressure on corporate earnings and household incomes.

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Japan

Hitoshi Asaoka
Chief Strategist

Yuko Iizuka
Economist

Economic Outlook

Japan's economy remained resilient in 2025, with the impact of U.S. tariff policies proving relatively modest. Following a rate increase in January, the Bank of Japan kept its policy rate unchanged but moved to sell ETFs and other market assets. In October 2025, the Takaichi administration took office, advocating a "responsible, proactive fiscal policy."

Looking ahead, Japan's economy in 2026 is expected to remain solid supported by consumption driven by positive real wage growth and investment focused on efficiency. Inflation is shifting from cost-push to demand-pull. With the price stability target now achieved, further rate hikes by the Bank of Japan are anticipated.

Under household support measures and bold investment promotion policies introduced by the Takaichi administration, interest rates are likely to rise. However, economic growth underpinned by proactive fiscal policy should boost tax revenues, helping to offset upward pressure on rates stemming from fiscal concerns.

Key risks include:

•Deterioration in Japan–China relations

•Sharp interest rate hikes or rapid yen depreciation amid heightened fiscal concerns

•Legislative gridlock under a minority government

Forecast Summary

Calendar Year	Actual 2023	Actual 2024	AMO's Estimate 2025	AMO's Forecast 2026
Real GDP (YoY, %)	0.7	-0.2	1.2	0.7
Core CPI (YoY, %)	3.1	2.6	3.0	1.8
BOJ Policy Rate(%)	-0.10	0.25	0.75	1.00
JGB 10-Year Yield (%)	0.61	1.10	1.90	1.90
USD/JPY	141	157	155	144
TOPIX EPS	171	188	194	218
YoY, %	17.8	10.3	3.1	12.4
TOPIX	2366	2785	3350	3550
YoY, %	25.1	17.7	20.3	6.0

Source: Bloomberg, Factset, Asset Management One Co., Ltd.
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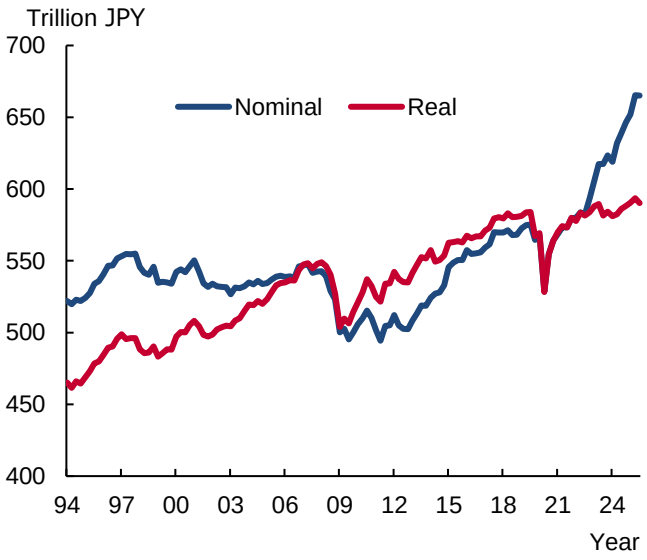
Japan's Economy in 2025

Japan's economy in 2025 contended with rising prices and the imposition of U.S. tariffs, yet remained resilient. Although growth dipped into negative territory in the July–September quarter, real GDP for the year is expected to exceed the estimated potential growth rate, settling in the low zero-percent range. Nominal GDP is projected to expand by approximately 4%, marking robust growth. Having already surpassed 600 trillion yen in 2023, nominal GDP is expected to increase further (Figure 1).

1. Trends in Domestic and External Demand

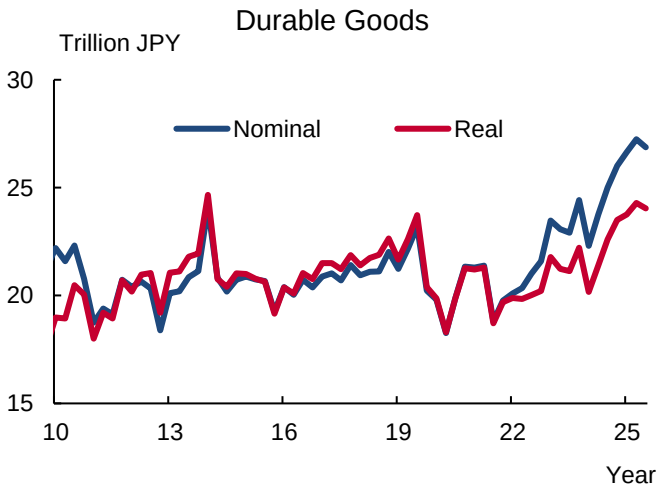
Looking at domestic demand, personal consumption increased not only in nominal terms but also in real terms, despite rising prices. By category, real consumption of non-durable goods was restrained due to soaring prices, particularly for food; however, consumption of durable goods and services grew. This was supported by a favourable employment environment and rising wages. Nominal employee compensation expanded beyond 300 trillion yen, while real employee compensation recovered to nearly the pre-COVID 2019 level (Figure 2).

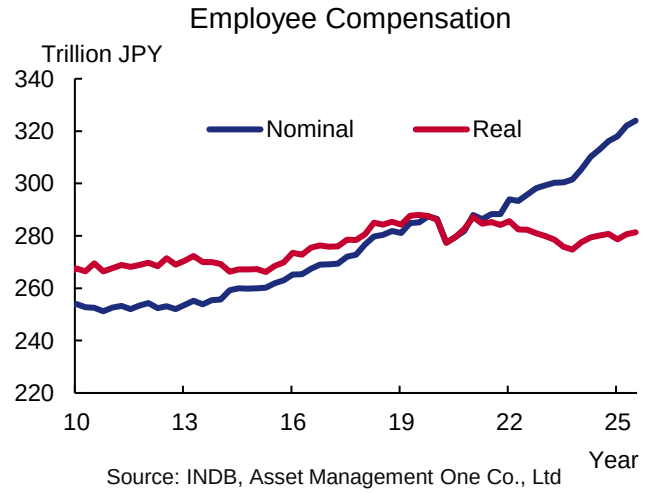
Figure 1: Nominal and Real GDP



Source: INDB, Asset Management One Co., Ltd.
Note: Quarterly data from Q1 1994 to Q3 2025

Figure 2: Personal Consumption by Goods and Services and Employee Compensation





Source: INDB, Asset Management One Co., Ltd
Note: Quarterly data from Q1 2010 to Q3 2025

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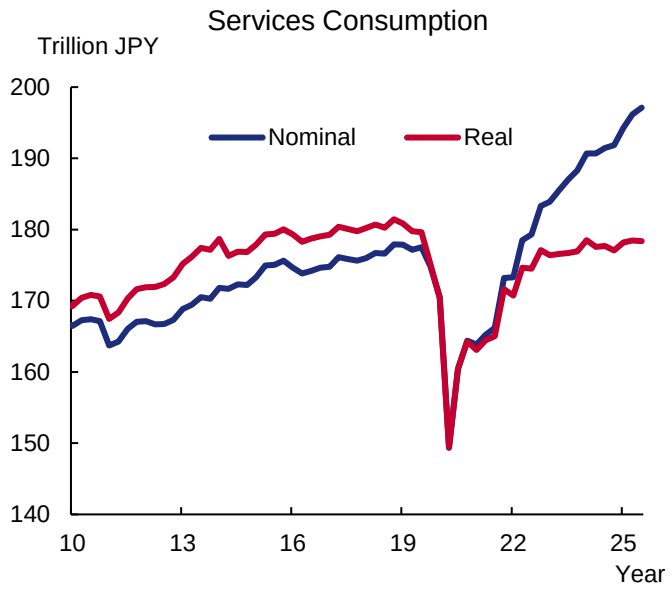
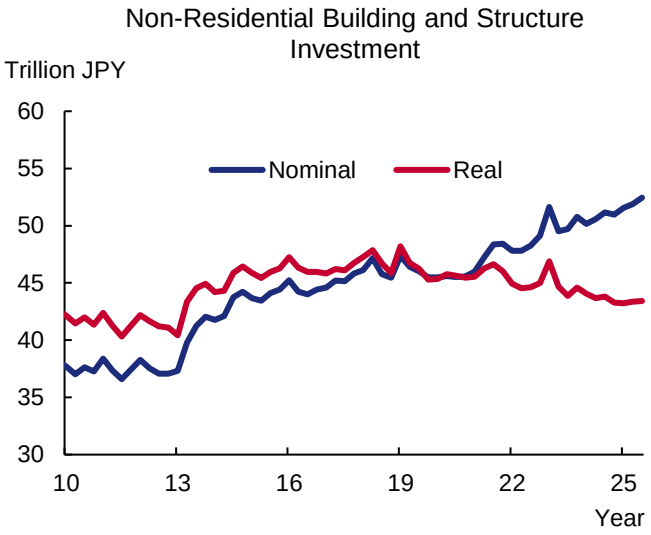
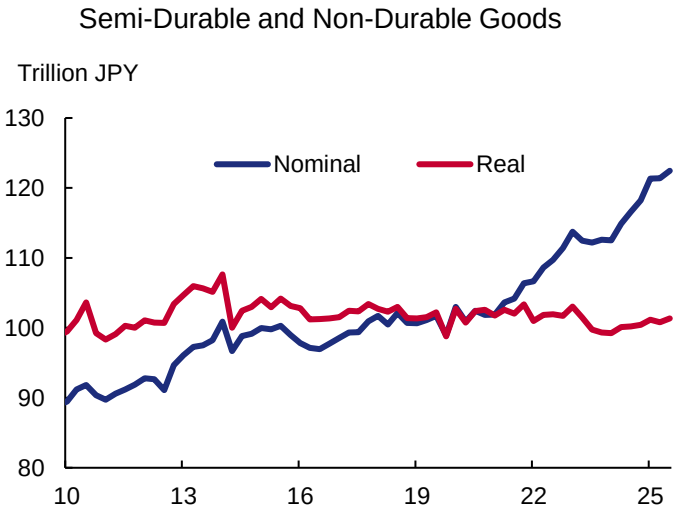
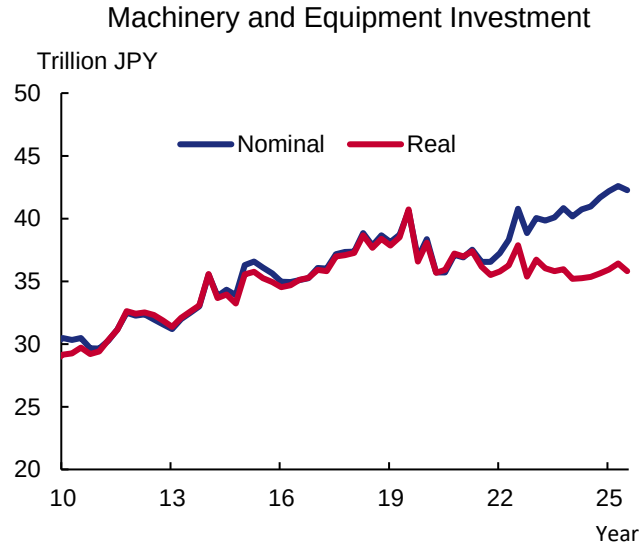
Figure 3 : Capital Investment by Type



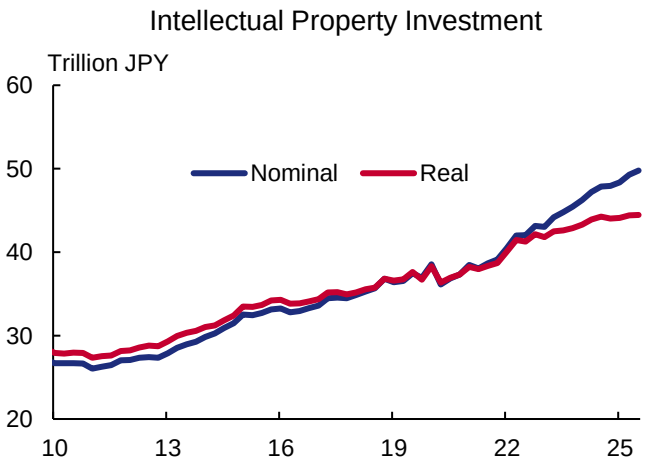






Source: INDB, Asset Management One Co., Ltd
Note: Quarterly data from Q1 2010 to Q3 2025

Capital investment increased both nominally and in real terms, despite concerns about negative impacts on corporate performance stemming from U.S. tariff measures. Growth was particularly strong in intellectual property investment, including software, but investment in machinery and equipment also expanded. Investment in buildings and structures (excluding housing) was sluggish in real terms due to rising construction costs and labour shortages in the construction sector (Figure 3).



Source: INDB, Asset Management One Co., Ltd
Note: Quarterly data from Q1 2010 to Q3 2025

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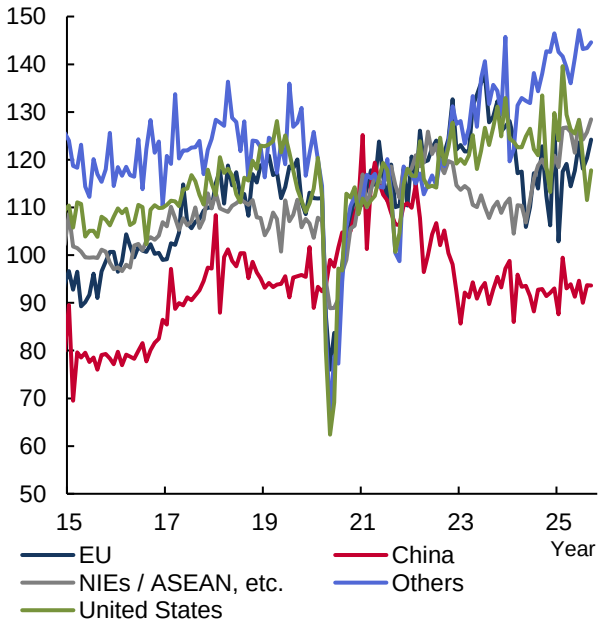
Housing investment showed significant fluctuations due to a reactionary decline following a rush ahead of the mandatory compliance with energy-saving standards in April 2025. While housing prices surged, expectations of higher mortgage rates drove an upward trend in housing investment, especially in urban areas.

Exports and imports were volatile, reflecting a surge in exports to the U.S. before tariff implementation and a subsequent reactionary decline However, by region, declines in export prices and volumes were limited to the U.S., while exports to other regions remained firm. By around October, signs of stabilization were also observed in export values to the U.S. (Figure 4

2. Price Trends

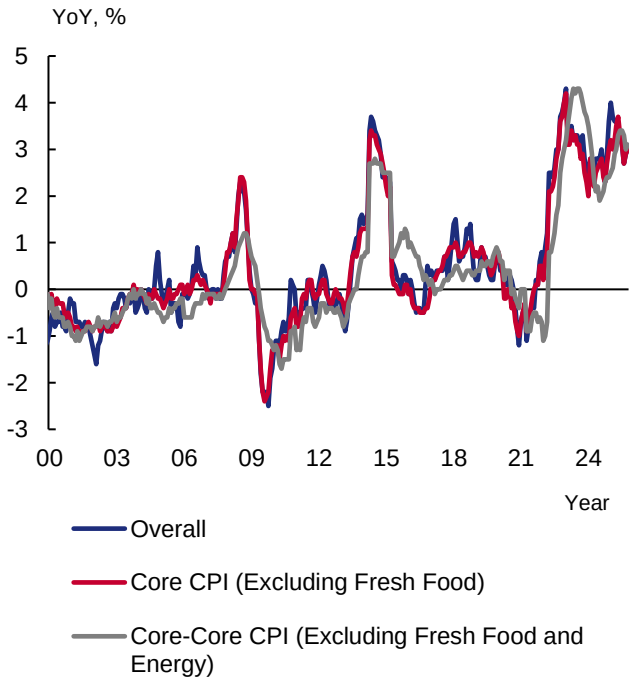
Core CPI (consumer prices excluding fresh food) has remained above +2% year-on-year since April 2022 (Figure 5). From December 2024 onward, it exceeded +3% year-on-year, driven by soaring rice prices, but fell back to the 2% range by August 2025 as rice prices stabilized. In the 2025 spring wage negotiations, the wage increase rate reached 5.25% (4.65% for small and medium-sized enterprises), marking a high level above 5% for the second consecutive year (according to Japanese Trade Union Confederation (RENGO) (Figure 6). Although real wages published by the Ministry of Health, Labour and Welfare remain negative, considering sample bias (downward skew) in wage statistics, they are judged to be approaching zero.

Figure 4: Real Exports by Destination Region



Source: INDB, Asset Management One Co., Ltd.
Note: Monthly data from January 2015 to September 2025
2020＝100

Figure 5: Consumer Prices



Source: INDB, Asset Management One Co., Ltd.
Note: Monthly data from January 2000 to September 2025

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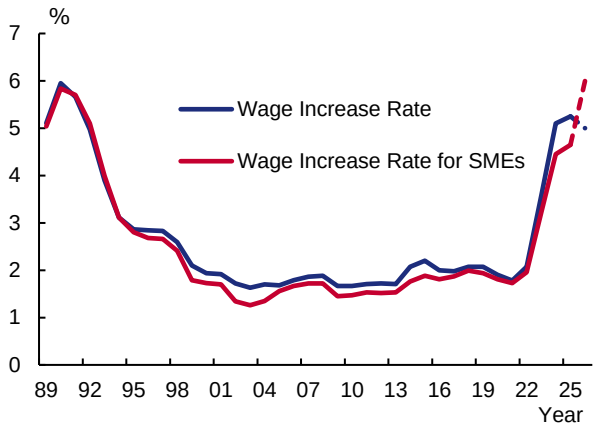
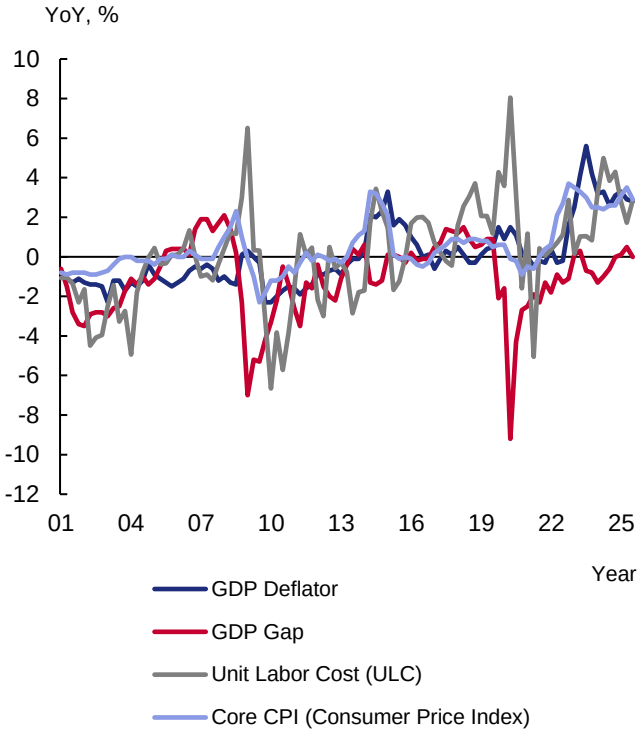
Figure 6: SHUNTO - Spring Wage Increase Rate



Source: RENGO , Asset Management One Co., Ltd.
Note: 1. Yearly data from 1989 to 2026
2. Final aggregated results for 1989–2025; 2026 reflects the Spring Wage Negotiation policy

Figure 7: Four Metrics for Judging Deflation Exit



Source: INDB, Bank of Japan, Asset Management One Co., Ltd
Note: Quarterly data from January 2001 to September 2025

Regarding the exit from deflation, all four indicators emphasized by the government have turned positive (Figure 7). Core CPI and the GDP deflator have remained above +2% year-on-year. Unit labour costs (nominal employee compensation / real GDP) have risen, driven by increased employee compensation amid employment growth and wage hikes. In addition, the output gap is near zero.

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3. Monetary Policy

After raising its policy rate from 0.25% to 0.5% in January 2025, the Bank of Japan has since kept rates unchanged. While noting that economic and price developments have broadly followed its projections and that confidence in achieving the price stability target has strengthened, the Bank remains cautious, citing the need to assess the potential impact of forthcoming US tariff measures on both domestic and global economies.

The Bank has continued the normalisation of quantitative easing, which had long been maintained under deflationary conditions. Its plan to reduce long-term government bond purchases has been adjusted: the quarterly reduction of around 400 billion yen through March 2026 will be scaled back to roughly 200 billion yen per quarter from April 2026 to March 2027. This reflects a desire to safeguard stability in the JGB market amid sharp rises in long and super-long yields, partly driven by expectations of fiscal expansion ahead of the July 2025 Upper House election.

At its September 2025 policy meeting, the Bank decided to begin selling its holdings of ETFs and J-REITs in the market. To minimise market disruption, the sale volume will be capped at 0.05% of total daily turnover. Based on current ETF holdings, the process would take more than a century to complete, underscoring the extremely gradual nature of this move.

4. Political and Fiscal Developments

In 2025, the ruling coalition (Liberal Democratic Party and Komeito) suffered a crushing defeat in the July Upper House election, leaving it a minority government in both chambers. Under the Ishiba administration in July 2025, Japan and the U.S. reached an agreement that included:

1. Reducing reciprocal tariffs imposed by the U.S. to 15%
2. Lowering automobile tariffs to 15%, including existing rates
3. Japan committing to invest $550 billion (approximately 80 trillion yen) in the U.S.

Immediately afterward, Prime Minister Ishiba announced his intention to resign. Following the LDP leadership election and the Diet's prime ministerial vote, the Takaichi administration was inaugurated in October, pledging aggressive fiscal stimulus and monetary easing in line with Abenomics. Financial markets responded with rising stock prices, higher interest rates, and yen depreciation. Komeito left the coalition, and the Takaichi administration formed a coalition with Japan Innovation Party (JIP).

The JIP and Prime Minister Takaichi share common ground on energy policy, including the use of nuclear power, and on security policy, such as strengthening defence. JIP advocates household relief measures such as:

- Zero consumption tax on food and beverages for two years
- Designing a refundable tax credit system benefiting low-income households
- Social security reforms to reduce social insurance premiums for working generations
- Free high school tuition and free elementary school lunches

On the other hand, JIP also demands institutional reforms that are likely to spark conflicts of interest, such as reducing the number of Diet seats, reforming health insurance, and establishing Osaka as a secondary capital. These issues could lead to difficult negotiations and potential legislative gridlock.

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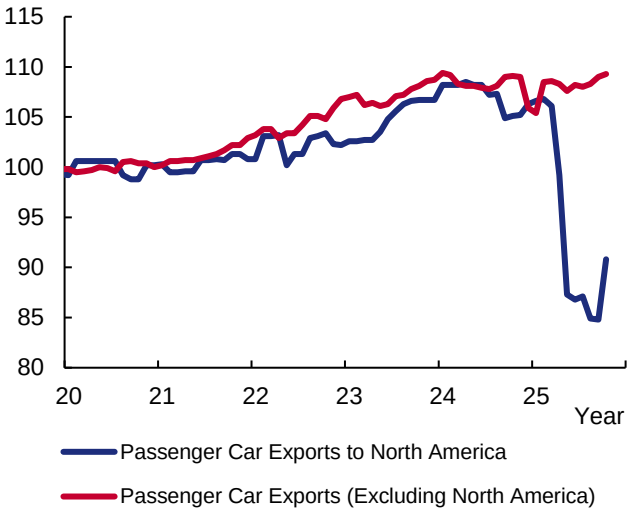
Japan's Economy in 2026

Japan's economy in 2026 is expected to remain resilient despite downward pressure from US tariffs on Japanese exports. While these tariffs, particularly affecting automobiles, which account for roughly 30% of exports to the US, pose challenges, robust domestic demand will provide a buffer. This strength will be underpinned by rising household income driven by strong wage growth and sustained investment in labour-saving technologies amid acute labour shortages. Economic measures under the Takaichi administration are also likely to offer further support.

1. Impact of US Tariffs

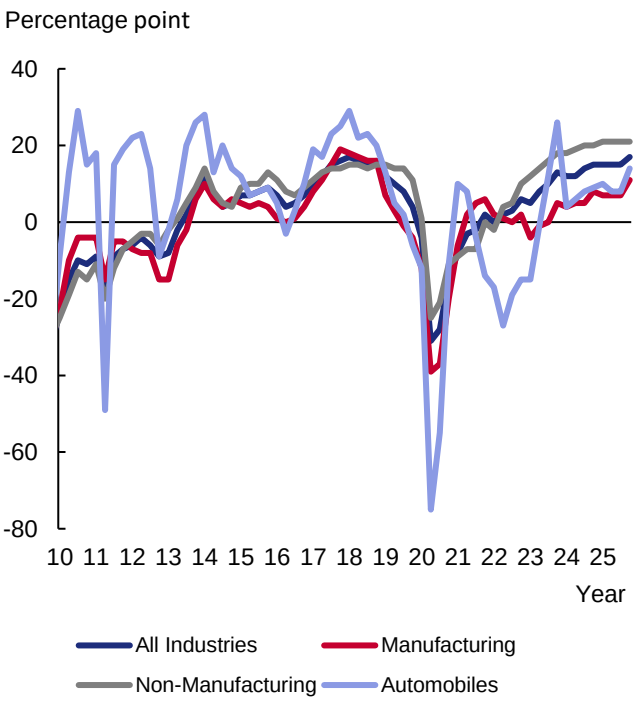
Automobile exports have borne the brunt of tariff-related headwinds. Passenger car export prices to North America fell by around 20% from May, as firms absorbed tariff costs rather than passing them on（Figure8）. However, October saw signs of price recovery, suggesting partial cost pass-through. Export volumes fluctuated sharply due to pre-tariff front-loading and subsequent corrections, but stabilisation emerged in October. Despite these challenges, the Bank of Japan's Tankan survey indicates business sentiment remains broadly firm (Figure 9).

Figure 8: Passenger Car Export Price Index



Source: INDB, Asset Management One Co., Ltd
Note 1.Monthly data from January 2020 to October 2025
2.Data are based on contract currency
3. 2020＝100

Figure 9: BoJ Tankan – Business Conditions DI



Source: INDB, Asset Management One Co., Ltd.
Note: Quarterly data from Q1 2010 to Q3 2025

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2. Domestic Demand

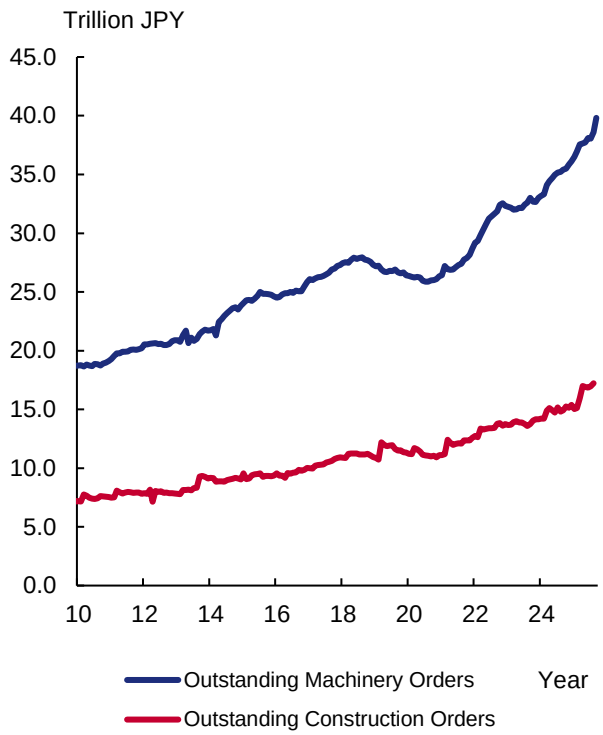
Private Consumption: Consumption expected to maintain an upward trajectory, supported by stable prices, favourable labour market conditions, and sustained wage growth. Consumer prices should moderate, aided by government measures such as fuel tax cuts and household energy subsidies.

Japanese Trade Union Confederation aims to entrench real wage growth of +1%, setting a benchmark of 5% or more for wage hikes in 2026, with SMEs targeting 6% or more. Japan Business Federation has signalled commitment to reinforcing this momentum. Consequently, spring wage negotiations are likely to deliver increases near 5%, ensuring real wages turn positive.

As consumers recognise the end of deflation and anticipate continued income gains, the incentive to delay purchases diminishes, boosting demand for durable goods and services. Consumer confidence, which bottomed out in May, is improving steadily.

Capital Expenditure: Investment will remain robust, led by software and automation projects aimed at addressing labour shortages. Elevated construction and machinery backlogs point to a prolonged investment cycle as these projects progress (Figure 10).

Figure 10: Build-up of Orders



Source: INDB, Asset Management One Co., Ltd.,
Note: Monthly data from January 2010 to September 2025; Machinery Orders as of October

3. Price Trends

Core CPI (excluding fresh food) is projected to remain below +2% year-on-year, reflecting subdued food prices and government relief measures (estimated to trim CPI by 0.3 percentage points). Goods inflation will soften, while service prices driven by rising labour costs should hover near 2%. Notably, service sectors with high labour cost ratios are seeing price increases above 3%, indicating successful cost pass-through.

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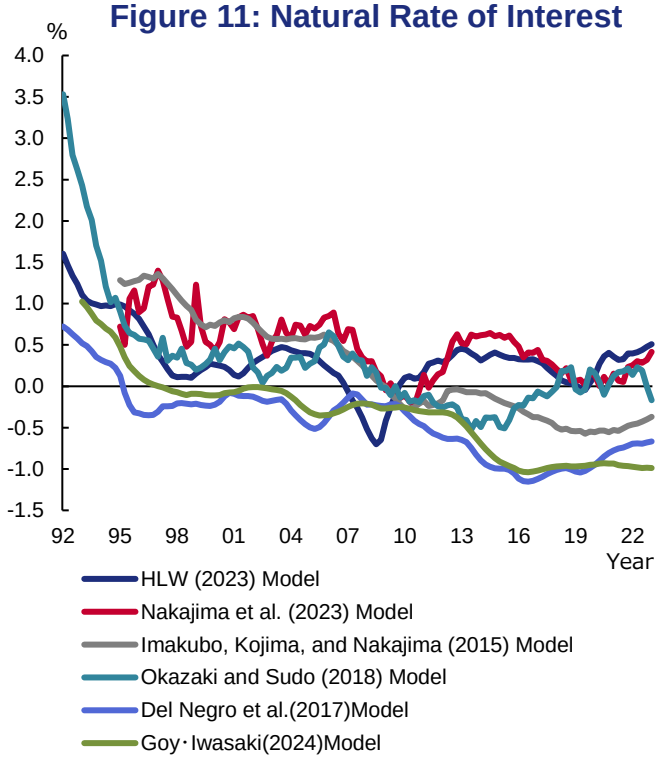
4. Monetary Policy

The October policy meeting revealed a more optimistic outlook, with progress toward the 2% inflation target. Prime Minister Takaichi emphasises the importance of demand-driven inflation and remains cautious about potential tariff impacts. Against this background, the Bank of Japan raised rates to 0.75% in December and is expected to hike further to 1.00% around July 2026. Natural rate estimates range from –1% to +0.5%, suggesting an initial neutral rate near +1%. （Figure 11）Should fiscal stimulus persist and output gaps widen, semi-annual hikes could continue, potentially reaching 1.50% by end-2027

Recent trends show both unit labour costs and unit profits rising concurrently a shift toward demand-pull inflation, aligning with the government's goal of transitioning from a low-pressure to a high-pressure economy.

Figure 11: Natural Rate of Interest



Source: Bank of Japan, Asset Management One Co., Ltd.
Note: 1.Quarterly data from Q1 1992 to Q1 2023
2. Nakajima et al. (2023) and Imakubo, Kojima, and Nakajima (2015) start from Q1 1995, while Goy and Iwasaki (2024) start from Q1 1993.

5. Political and Fiscal Policy

On November 21, the Cabinet approved an economic package totalling approximately 42.8 trillion yen in project size and 21.3 trillion yen in national expenditure, exceeding last year's package of around 39.0 trillion yen. The measures include direct household relief against rising prices, such as (Figure 12):

1. Priority support grants to local governments, including rice coupons
2. Electricity and gas bill reduction programs and temporary suspension of the gasoline tax
3. Child-rearing support allowances to offset price increases
4. Revision of the income tax threshold (reintroduced from a previous administration's decision)

Figure 12: Direct Relief Amount for Households Facing High Prices under Economic Measures (Approximately Over the Next Year)

Priority Support Local Grants Includes support for households using LP gas, water bill reductions, premium vouchers, rice coupons, etc.	¥2.0 trillion
Electricity and Gas Bill Relief Measures From January to March 2026, approximately ¥7,000 per household	¥0.5 trillion
Abolition of Temporary Gasoline Tax Rate Gradual price reduction starting November 13, 2025.	¥1.0 trillion
Child-Rearing Support Allowance for Coping with High Prices ¥20,000 per child	¥0.4 trillion
Income Tax "Annual Income Barrier" Adjustment (Decided under Previous Administration) Starting with year-end tax adjustment in December 2025	¥1.2 trillion

Source: Japan Cabinet Office, Asset Management One Co., Ltd.

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Household support measures amount to roughly 4 trillion yen (excluding the income tax threshold revision), with an estimated GDP growth boost of about 0.2%. Other initiatives include crisis management and growth investments, as well as strengthening defence and diplomacy. Notably, the package emphasizes economic security by targeting 17 strategic sectors, such as AI, semiconductors, and shipbuilding for public-private investment and supply chain reinforcement, which are expected to enhance resilience and promote growth.

While the project size exceeds last year's, the government aims to keep this year's government bond issuance (after supplementary budget compilation) below last year's post-supplementary issuance of 42.1 trillion yen, signalling consideration for fiscal credibility.

Looking ahead, attention will focus on the 2026 tax reform and budget. Under the previous administration, the income threshold was raised from 1.03 million yen to 1.6 million yen with restrictions, resulting in 1.2 trillion yen in tax cuts. Future discussions include whether to raise the threshold to 1.78 million yen (as proposed by the Democratic Party for the People, requiring about 7 trillion yen in funding) or link it to overall inflation or food price inflation. The coalition agreement with JIP also includes examining zero consumption tax on food for two years, designing refundable tax credits for low-income households, and reducing social insurance premiums for working generations.

The chair of the Tax Commission—traditionally a figure opposed to tax cuts—is now Itsunori Onodera, who is not from the commission, signalling a fresh approach to tax reform discussions. Finance Minister Satsuki Katayama, a former Finance Ministry official, is expected to act as a bridge between the ministry and the administration, balancing proactive fiscal policy with discipline

The Takaichi administration has shifted its fiscal consolidation target from achieving a primary balance surplus to focusing on the government debt-to-GDP ratio (Figure 13). This ratio depends on (1) nominal GDP growth (real GDP growth + GDP deflator increase) and interest payments, and (2) the primary balance (Figure 14). While the primary balance moves toward surplus, maintaining the so-called "Domar condition"—where nominal GDP growth exceeds interest rates—is crucial. Over the past decade, low interest rates have often kept rates below nominal GDP growth. Going forward, with additional Bank of Japan rate hikes and proactive fiscal policy expected, concerns may rise over higher interest payments and spending. However, recent improvements in the debt-to-GDP ratio have been largely driven by nominal GDP growth.

In an inflationary environment, whether nominal GDP growth continues to outpace interest rates will be key to fiscal sustainability. This underscores the need for household relief measures and bold investment promotion policies that lead to future tax revenue growth, rather than focusing solely on fiscal discipline.

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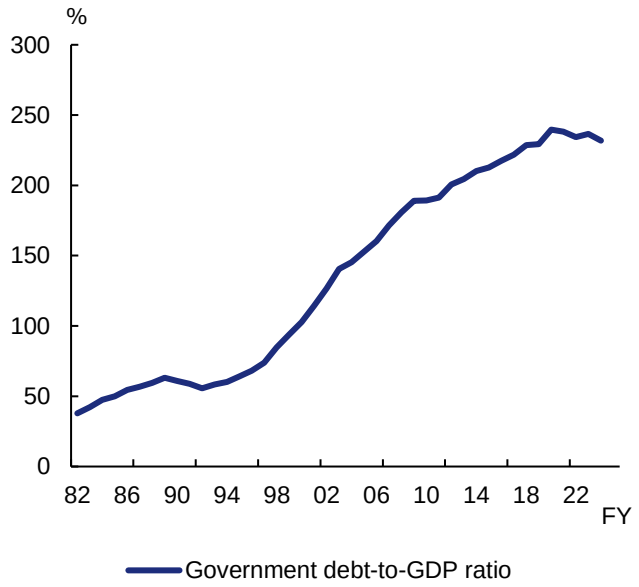
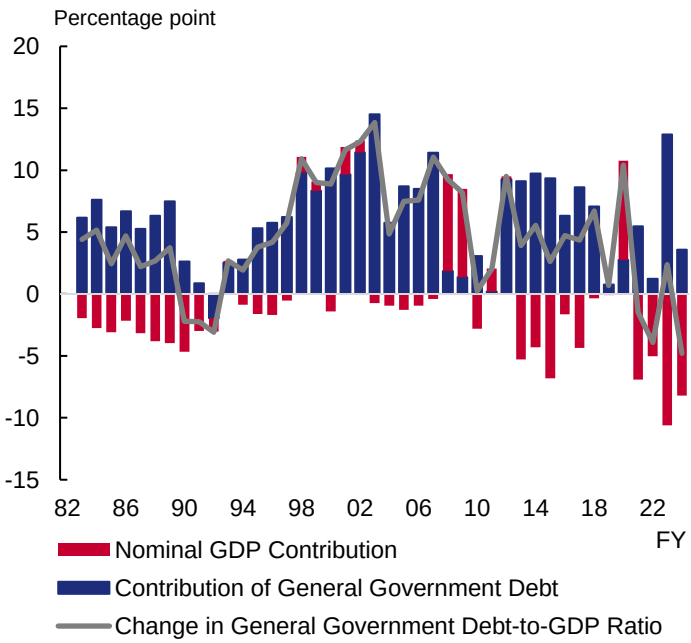
Figure 13: Nominal Debt-to-GDP Ratio



Source: INDB, Asset Management One Co., Ltd.
Note: Yearly data from FY1982 to FY2024

Figure 14: Decomposition of Contributions to Changes in the Nominal Debt-to-GDP Ratio



Source: INDB, Asset Management One Co., Ltd.
Note: Yearly data from FY1982 to FY2024

6. Political Landscape and Risk Factors

Prime Minister Takaichi's term as LDP president runs until September 2027. Unless her current high approval ratings drop significantly, the LDP is expected to continue supporting her. The next Upper House election is scheduled for July 2028, and the Lower House term lasts until October 2028 unless dissolved earlier. Takaichi is likely to focus on delivering results through the FY2025 supplementary budget (economic stimulus) and the FY2026 budget, making an early dissolution unlikely for now. However, given the LDP's slim majority in the Lower House and minority status in the Upper House, if passing the budget becomes difficult, the risk of dissolution could rise by spring 2026, leveraging her strong approval ratings.

The coalition partner, JIP is pushing for institutional reforms that often involve conflicting interests among parties, such as reducing the number of Diet seats, health insurance reform, and establishing Osaka as a secondary capital. These could lead to protracted negotiations and legislative gridlock.

On foreign relations, Takaichi's remarks on a potential "Taiwan contingency" prompted China to demand a retraction and impose measures such as advising against travel and study in Japan, halting Japanese film screenings, canceling events, and restricting imports of Japanese seafood. Given that Japan is unlikely to retract the statement, this issue may persist. Inbound tourism reached 35.54 million visitors by October 2025 (year-to-date), making it almost certain to surpass the previous record of 36.87 million in 2024. Chinese visitors account for about 23% of total arrivals (2025 estimate). Inbound spending in Q3 2025 was about 9 trillion yen annually, roughly 1.4% of nominal GDP, with Chinese visitors contributing around 28%.

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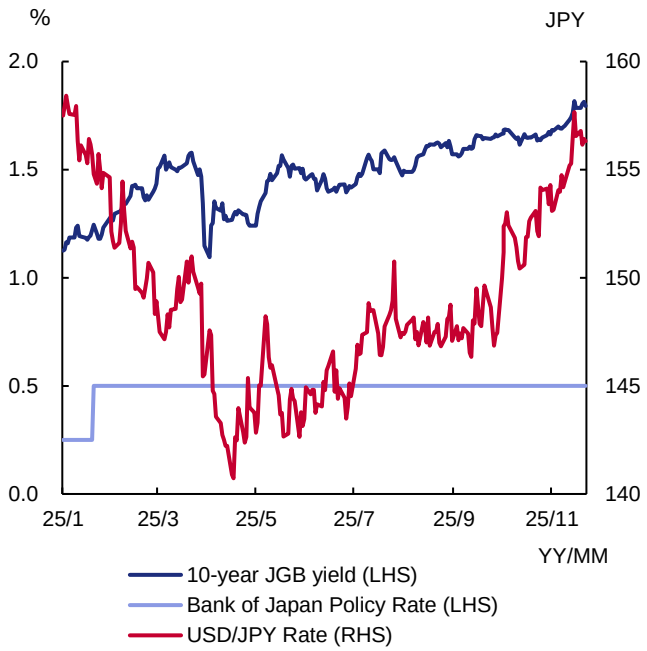
If Chinese inbound spending were halved, nominal GDP could be pushed down by about 0.2 percentage points. Chinese tourists tend to stay longer and spend more on entertainment and services, meaning certain sectors could face significant impacts. The 2026 Lunar New Year holiday (Feb 14–22) spans nine days, raising concerns about prolonged tensions. However, since many Chinese visitors are repeat individual travelers, the extent of cancellations remains uncertain.

China also announced restrictions on Japanese seafood imports, but given that Japan's food exports to China (including seafood) totaled only 115.1 billion yen in 2024, the overall economic impact is expected to be limited. More concerning would be potential visa restrictions, punitive measures against Japanese firms (tax audits, fines, business suspensions, employee detentions), or rare earth export bans. However, harsh measures such as detaining Japanese nationals could deter foreign investment and prompt corporate exits from China, making such actions unlikely.

Finally, if markets perceive that Takaichi's "responsible proactive fiscal policy" undermines fiscal discipline, there is a risk of sharp rises in long-term interest rates and rapid yen depreciation. Moreover, if yen weakness fuels inflation and the administration resists Bank of Japan monetary tightening, further yen depreciation could occur (Figure 15).

Figure 15: Policy Rate, Long-term JGB Yield, and USD/JPY Rate



Source: LSEG Datastream, Asset Management One Co., Ltd.
Note: Daily data from 6 January 2025 to 27 November 2025

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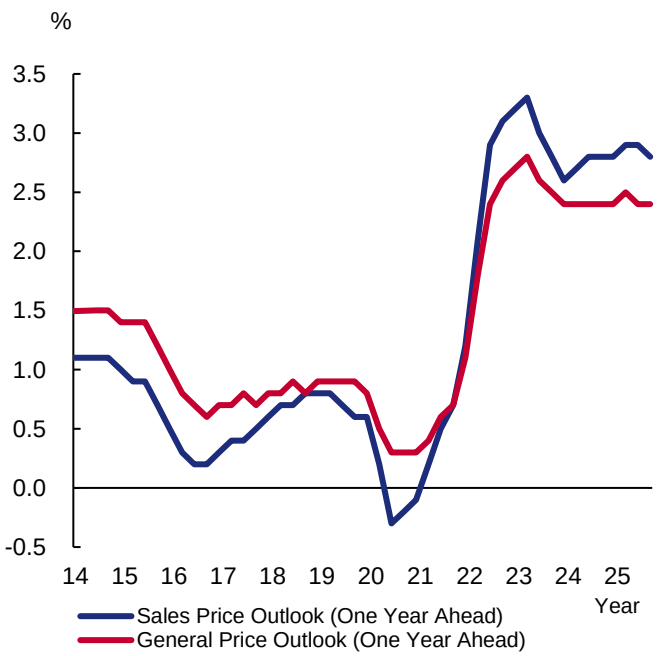
Market Outlook

1. Japanese Equities

With inflation becoming entrenched and nominal GDP continuing to expand, corporate revenues and earnings are expected to grow steadily, although growth remains driven more by pricing than by volume. According to the Bank of Japan's Tankan survey, sales price expectations remain above overall price outlooks, suggesting that cost pass-through continues (Figure 1).

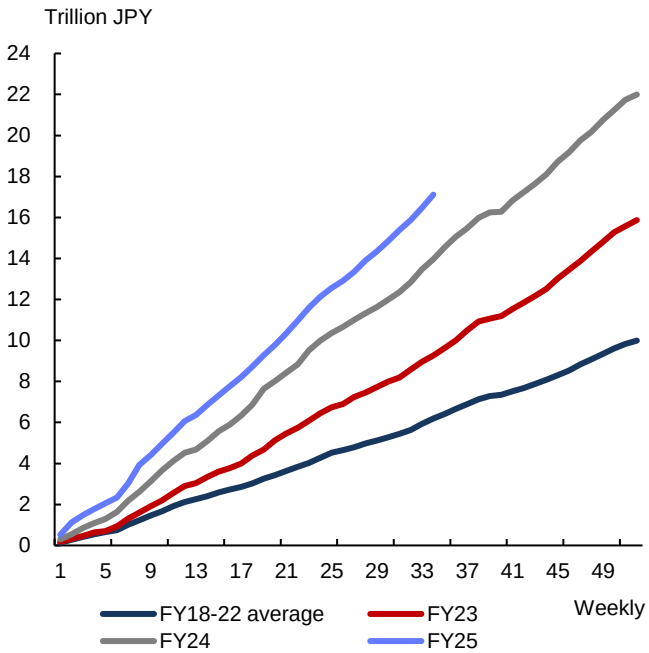
Figure 1: Corporate Price Outlook All Sizes, All Industries (BoJ Tankan Survey)



Source: Bloomberg, Asset Management One Co., Ltd.
Note: Quarterly data from Q1 2014 to Q3 2025

Efforts by listed companies to improve capital efficiency prompted by requests from the Tokyo Stock Exchange and revisions to the Corporate Governance Code are expected to persist this year, supported by shareholder returns such as share buybacks. Share repurchases are on track to exceed 20 trillion yen in FY2025, and sizable buybacks are likely over the next few years, underpinning demand for Japanese equities (Figure 2). Major domestic financial institutions, including megabanks and large insurers, have indicated plans to continue selling cross-shareholdings through FY2030. For companies, whose shares were previously held as policy holdings, this creates opportunities for buybacks, while financial institutions can use proceeds from such sales for their own repurchases.

Figure 2: Share Buybacks by Listed Companies (TSE Two markets)



Source: Bloomberg, Asset Management One Co., Ltd.
Note: Weekly data from FY2018 to FY2025. Cumulative purchase amount from April onward for each fiscal year. For FY2025, data is up to the week of November 17–21, 2025

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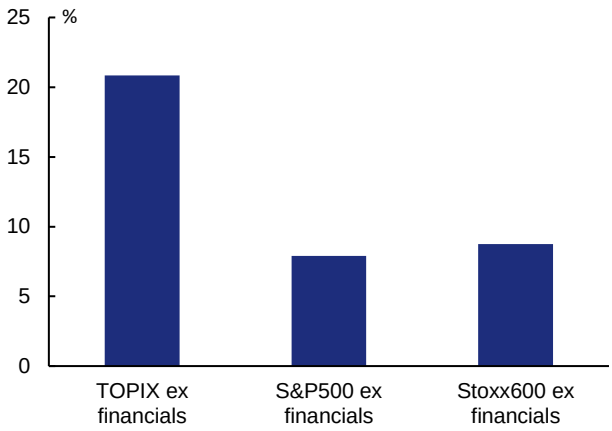
The upcoming 2026 revision of the Corporate Governance Code will focus on cash hoarding. Japanese listed firms maintain higher cash ratios than their U.S. and European peers (Figure 3), largely due to prolonged deflation. As attention shifts towards effective use of surplus funds, the capital efficiency drive initiated by the TSE's 2023 request and entering its fourth year in 2026 may accelerate further.

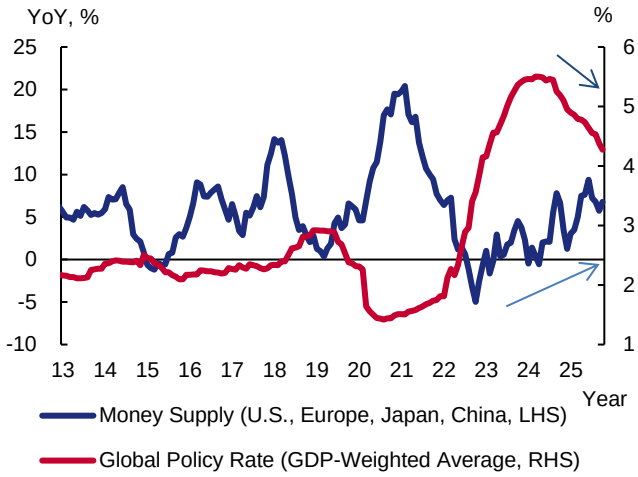
Figure 3: Ratio of Cash to Total Assets



Source: Bloomberg, Asset Management One Co., Ltd.
Note: As of 28 November 2025

Globally, continued Fed rate cuts and the resulting dollar weakness are expected to boost liquidity, alongside a recovery in the U.S. economy, creating a favourable backdrop for Japanese equities (Figure 4). Political stability under Prime Minister Takaichi, supported by the LDP–Japan Innovation Party (Ishin) coalition, should also be viewed positively by overseas investors.

Figure 4: Expansion of Global Liquidity



Source: IMF, Bloomberg, Asset Management One Co., Ltd.
Note: 1 Monthly data from January 2013 to October 2025
2 Money supply refers to the year-on-year change in the combined dollar-denominated M2 for the United States, the euro area, Japan and China. The global policy rate represents the weighted average of policy rates across 27 central banks worldwide, using 2023 nominal GDP in U.S. dollars as weights.

Although the LDP–Komeito alliance has dissolved, the new coalition is expected to secure a majority in the Lower House with additional independents joining. The yen's depreciation largely driven by short-term players following the halt in U.S. economic data releases and the formation of the Takaichi administration in autumn 2025 is likely to pause, easing concerns about Japanese equities in dollar terms (Figure 5).

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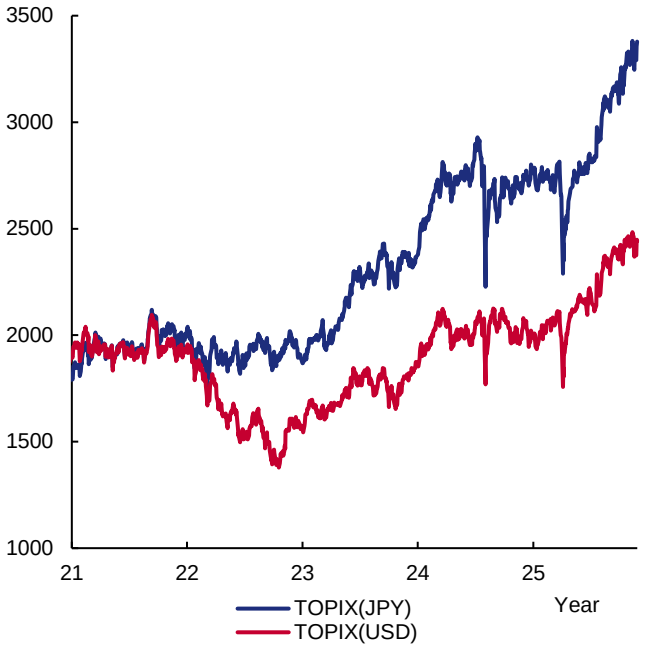
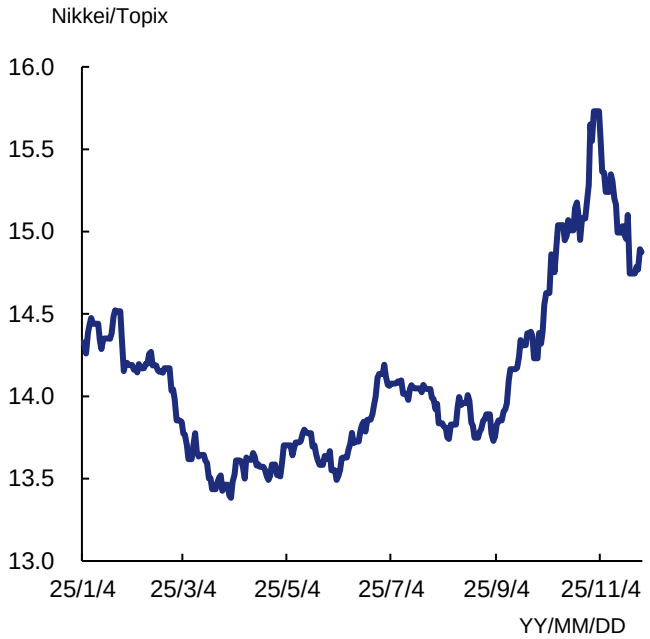
Figure 5: TOPIX (in JPY and USD)



Source: Bloomberg, Asset Management One Co., Ltd.
Note: Daily data from 4 January 2021 to 28 November 2025

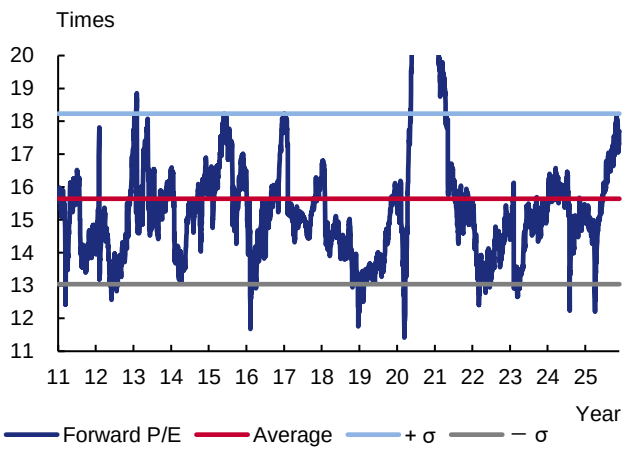
Figure 6: NT (Nikkei-to-TOPIX) Ratio



Source: Bloomberg, Asset Management One Co., Ltd.
Note: 1. Daily data from 4 January 2025 to 28 November 2025
2. NT Ratio represents the relative performance of the Nikkei 225 index to the TOPIX index (Nikkei ÷ TOPIX). A rising ratio indicates Nikkei 225 is outperforming TOPIX, while a falling ratio suggests broader market strength.

In 2025, global rallies in AI-related stocks pushed the Nikkei 225 price-weighted index well ahead of TOPIX, a market-cap-weighted index, driving the NT ratio (Nikkei-to-TOPIX ratio) to historic highs (Figure 6). In 2026, broader earnings growth should correct this excessive concentration in a handful of names. However, valuations expanded in summer 2025 as markets priced in FY2026 earnings earlier than usual and further widened in autumn on optimism over the Takaichi administration (Figure 7). These valuation premiums are expected to gradually revert toward the mean, reflecting typical mean reversion dynamics.

Figure 7: TOPIX Forward 12-Month P/E



Source: Bloomberg, Asset Management One Co., Ltd.
Note: 1. Daily data from 4 January 2011 to 28 November 2025
2. P/E shown in this chart is based on forecast EPS for the next 12 months
3. Periods during COVID-19 when P/E exceeded 20x are not shown
4. σ indicates the standard deviation for the displayed period.

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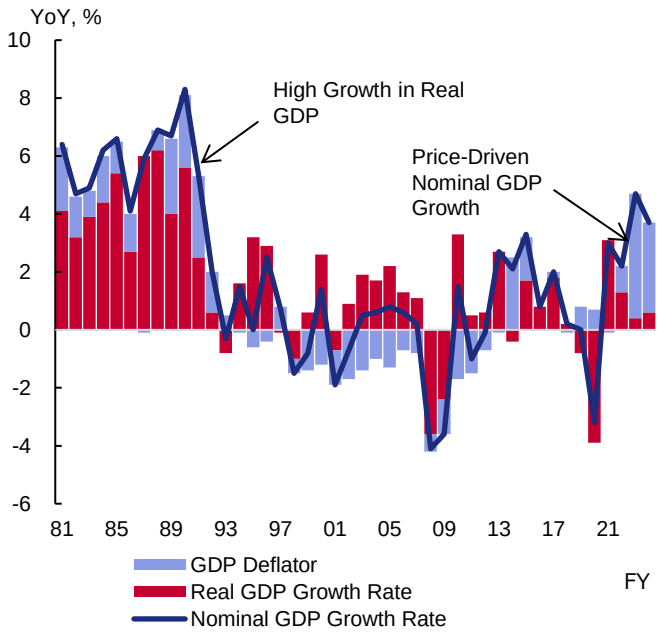
While deterioration in Japan–China relations remains a concern, current Chinese regulatory tightening towards Japan appears limited, with minimal impact on manufacturing. Japanese equities have risen but gains in 2025 were led by AI-related stocks. Corporate earnings growth was driven more by price increases than by volume (Figure 8). In 2026, attention will focus on whether volume-driven growth materializes.

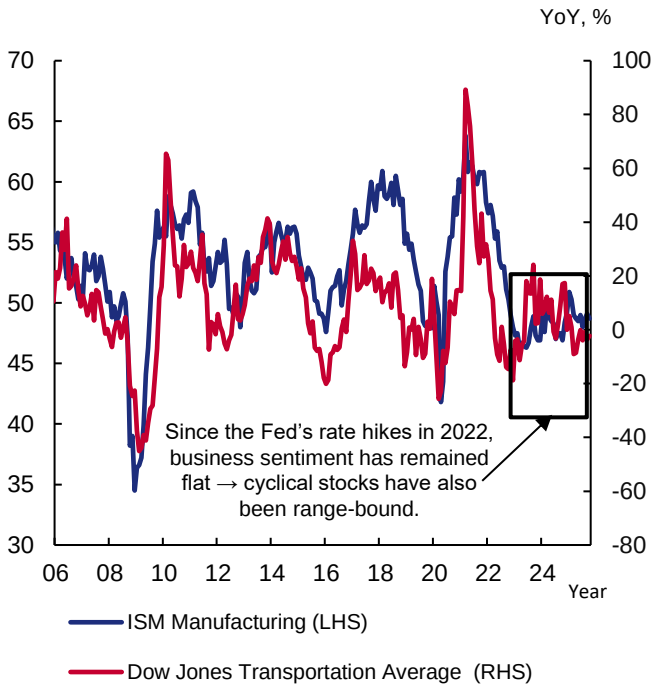
Figure 8: Nominal GDP Growth Rate



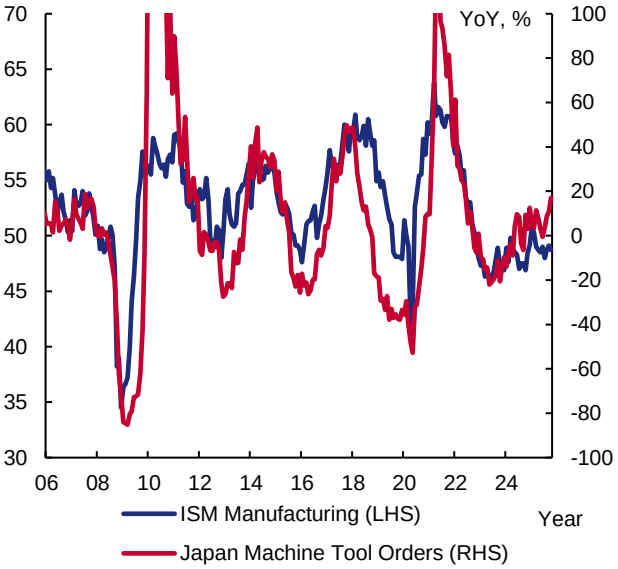
Source: INDB, Asset Management One Co., Ltd.
Note: Yearly data from FY1981 to FY2024

The concentration in AI-related names reflects, in part, subdued global trade and a flat U.S. economy, which weighed on traditional cyclical stocks. Lingering stagnation limited sector rotation beyond AI. Following the Fed's aggressive rate hikes in 2022, cyclical indicators remained flat, underscoring the drag from high interest rates (Figure 9). Going forward, as Fed rate cuts progress and U.S. economic recovery strengthens, investor focus may shift towards cyclical names. For Japan, machine tool orders and other indicators tend to move in tandem, and Japanese equities typically viewed as cyclical globally should benefit from this recovery.

Figure 9: Business Cycle and Cyclical Stocks



Source: Bloomberg; Asset Management One Co., Ltd.
Note: Monthly data from January 2006 to October 2025



Source: Bloomberg; Asset Management One Co., Ltd.
Note: Monthly data from January 2006 to October 2025

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2. Domestic Long-Term Interest Rates

Japanese long-term yields are expected to maintain a gentle upward trajectory, with markets closely monitoring the Bank of Japan's stance on rate hikes. However, there is a notable risk of a sharp rise in ultra-long maturities during the January–March quarter, when the FY2026 budget is under discussion, driven by speculation over fiscal expansion. A snap general election could allow the LDP to secure a stronger majority, increasing policy flexibility under the Takaichi administration and fuelling expectations of fiscal stimulus. That said, the ruling bloc does not hold a majority in the Upper House, and the need to incorporate measures such as consumption tax cuts previously advocated by some opposition parties has diminished, suggesting that fiscal expansion may remain limited

3. Foreign Exchange

In 2025, the dollar/yen exchange rate moved against the Japan–U.S. short-term interest rate differential, with the yen weakening and the dollar strengthening (Figure 10). This was driven by uncertainty surrounding the Fed's rate-cut path and the so-called "Takaichi trade." The suspension of key U.S. economic indicators further clouded visibility on U.S. yields.

Looking ahead, we expect the historical correlation with the interest rate differential reflecting monetary policy divergence to reassert itself in 2026, pointing towards yen appreciation and dollar depreciation. Nonetheless, during Q1 2026, renewed yen-selling pressure could emerge amid speculation over FY2026 budget negotiations and a possible dissolution of the Lower House.

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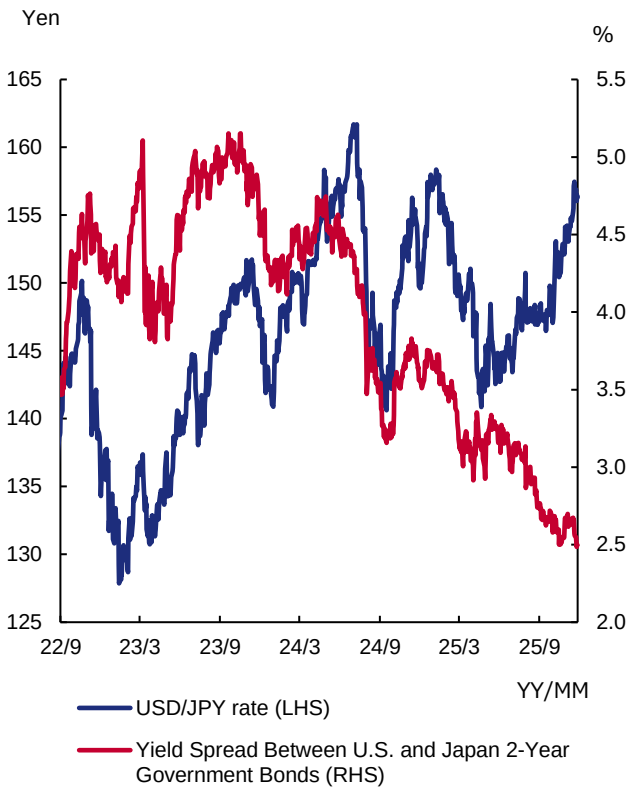
Figure 10: USD/JPY and U.S.–Japan 2-Year Yield Spread



Source: Bloomberg; Asset Management One Co., Ltd.
Note: Daily data from 1 September 2022 to 27 November 2025

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4. Risk Factors

On the downside, risks include a deepening sense of stagnation in both Japan and the United States, which could slow the pace of earnings growth in AI-related stocks. Added to this are heightened uncertainties surrounding monetary policy in the two economies, the possibility that Japan's domestic recovery fails to take hold, and the risk of political instability at home. Further deterioration in Japan–China relations could also lead to tighter regulatory constraints on manufacturing activity, amplifying headwinds for the real economy.

Conversely, upside risks centre on the prospect of a sharp rebound in growth in the United States and China. Within Japan, stronger domestic demand could emerge, supported by wage increases and the stabilisation of inflation, which would in turn bolster consumption and capital investment.

From a market perspective, lingering concerns over fiscal deterioration across advanced economies continue to cast a shadow, raising the possibility of disorderly spikes in yields. For Japan, a temporary scenario of "triple depreciation" affecting the yen, equities and bonds cannot be ruled out should fiscal anxieties intensify.

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